

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

IN RE: CHRISTOPHER MICHAEL COTE,
Debtor.

CHRISTOPHER MICHAEL COTE,
Plaintiff and Appellant,
v.
EMPLOYMENT DEVELOPMENT
DEPARTMENT,
Defendant and Appellee.

Case No. 14-cv-05413-RMW
Bankruptcy Case No. 12-53464-SLJ
Chapter 7
Adv. Pro. No. 13-05078

**ORDER AFFIRMING JUDGMENT OF
BANKRUPTCY COURT**

Re: Dkt. No. 5

Before the court is an appeal by Christopher Cote from a judgment entered by the Hon. Stephen L. Johnson of the Bankruptcy Court for the Northern District of California. The judgment held that all four types of tax owed by appellant: unemployment insurance tax, employment training tax, state disability insurance withholdings, and state personal income tax withholdings, are non-dischargeable through bankruptcy. This court has jurisdiction under 28 U.S.C. § 158(a). For the reasons set forth below, the court AFFIRMS the bankruptcy court's judgment.

I. BACKGROUND

This dispute centers on the dischargeability of tax liability owed by appellant Christopher Cote to the California Employment Development Department (“EDD”). Appellant was the president and sole shareholder of a transportation and distribution company called “Cote Distribution Systems, Inc.” (“CDS”). Appellant’s Appendix (“AA”) 30. The EDD audited and found that CDS’s drivers were employees and not independent contractors. AA 129. It then assessed retroactive tax liability on CDS for failure to withhold state employment taxes on the newly classified employees on October 21, 1988. *Id.* CDS then filed an administrative petition for reassessment of the tax liability with the California Unemployment Insurance Appeals Board (“CUIAB”) (Case Number CT-12023-0001-A). AA 130. During this proceeding, Cote provided additional evidence showing employment began earlier than previously thought by the EDD. AA 349–50. The EDD revised the tax liability based on this new information and issued a larger assessment against CDS. AA 350. Cote, on behalf of CDS, and the EDD subsequently stipulated to the revised liability in 1988 (“the Stipulation”) and CDS withdrew its petition from the CUIAB. AA 92, 130, 312–13, 349–50.

CDS was dissolved in 1990, and the EDD opened an audit against Cote as a responsible person for CDS. AA 93, 130. Following the audit, on October 31, 1991 the EDD assessed the employment tax liability owed by CDS against Cote under California Unemployment Insurance Code (“CUIC”) § 1735. AA 314. The tax liability at issue in this appeal covers the period from the second quarter of 1982 through the fourth quarter of 1987. The tax liability comprises four categories of employment tax: unemployment insurance tax, employment training tax, state disability insurance withholdings, and state personal income tax withholdings. AA 31. No tax return for this period was ever filed either by Cote or anyone on behalf of CDS. AA 291, 293. Cote thereafter filed a petition for reassessment of the tax liability against him as an individual with the CUIAB (Case Number 2100427) (formerly Case Number 2009292) on December 2, 1991. AA 128, 131.

1 A year later, appellant filed for Chapter 7 bankruptcy (Bankruptcy Case No. 92-56617) in
2 1992 and received a discharge on January 29, 1993. AA 94. CDS also filed for Chapter 7
3 bankruptcy (Bankruptcy Case No. 92-56723) in 1992 and the case was fully administered and
4 closed in March, 1997. *Id.*

5 Appellant filed for Chapter 7 bankruptcy for a second time on May 4, 2012 and received a
6 discharge on January 31, 2013. AA 95. While the second bankruptcy case was still pending, the
7 CUIAB issued a decision on Cote's petition for reassessment and upheld the 1992 proposed
8 assessment of the EDD on September 6, 2012. AA 128. The CUIAB affirmed the decision on
9 appeal on December 28, 2012. AA 125–127, 129–146.

10 On May 24, 2013 Cote filed this lawsuit in the bankruptcy court in an adversary
11 proceeding against the EDD. AA 18–24. Cote alleges three causes of action: (1) dischargeability
12 of the employment tax liability; (2) violation of the automatic stay; and (3) violation of the
13 discharge injunction. Only the first cause of action is at issue in this appeal. *Id.*

14 On March 17, 2014 Cote moved for summary judgment on the first cause of action. AA
15 72–275. On March 28, 2014 the EDD filed a cross-motion for summary judgment on the first and
16 third causes of action. AA 276–319. On April 29, 2014, the bankruptcy court denied appellant's
17 motion for summary judgment. AA 351–54. The bankruptcy court granted the EDD's cross-
18 motion and held that the state disability insurance withholdings and state personal income tax
19 withholdings are non-dischargeable "trust fund" taxes under 11 U.S.C. § 507(a)(8)(c) and
20 523(a)(1)(A). *Id.* The bankruptcy court declined to rule on the dischargeability of the
21 unemployment insurance tax and employment training tax due for lack of sufficient evidence in
22 the records. *Id.* The bankruptcy court also granted the EDD's cross-motion for summary judgment
23 as to the third cause of action for violation of the discharge injunction, without prejudice to
24 appellant bringing a properly noticed motion on that claim. *Id.*

25 On June 2, 2014 appellant filed a second motion for summary judgment on the first cause
26 of action only with respect to the dischargeability of the unemployment insurance tax and
27 employment training tax. AA 358–570. On September 12, 2014 the bankruptcy court denied

appellant's second motion for summary judgment, finding all four types of employment tax non-dischargeable. AA 627–45.

On September 22, 2014 the bankruptcy court dismissed the remaining second cause of action pursuant to the parties' stipulation. AA 646–48. On October 31, 2014 the bankruptcy court entered a judgment in favor of the EDD. AA 735–37. On November 4, 2014 appellant filed a notice of appeal in the Bankruptcy Appellate Panel for the Ninth Circuit. AA 738–39. On November 24, 2014 the EDD elected to have the appeal heard by this court. AA 758–59. Appellant filed his opening brief on January 23, 2015, Dkt. No. 5, appellee filed a response on February 27, 2015, Dkt. No. 8, and appellant filed a reply brief on March 11, 2015, Dkt. No. 9.

II. ANALYSIS

A. Standard of Review

This court reviews the bankruptcy court's findings of fact for clear error. Fed. R. Bankr. P. 8013; *In re Acequia, Inc.*, 787 F.2d 1352, 1357 (9th Cir. 1986). Under this standard, the district court "accept[s] findings of fact made by the bankruptcy court unless these findings leave the definite and firm conviction that a mistake has been committed by the bankruptcy judge." *Latman v. Burdette*, 366 F.3d 774, 781 (9th Cir. 2004). The court reviews de novo the bankruptcy court's legal conclusions and mixed questions of law and fact. *In re Lee*, 179 B.R. 149, 155 (9th Cir. B.A.P. 1995).

Lastly, the court reviews the bankruptcy court's evidentiary rulings for abuse of discretion. "[T]o reverse on the basis of an erroneous evidentiary ruling, [the court] must conclude both that the bankruptcy court abused its discretion and that the error was prejudicial." *Latman*, 366 F.3d at 786 (citing *McEuin v. Crown Equip. Corp.*, 328 F.3d 1028, 1032 (9th Cir. 2004)).

B. Unemployment Insurance Tax and Employment Training Tax are Non-Dischargeable Under 11 U.S.C. § 523(a)(1)(B)(i)

Generally, a debtor is discharged from personal liability for all debts incurred before the filing of a Chapter 7 bankruptcy petition, including liability related to unpaid taxes. *See* 11 U.S.C. § 727(b). However, the Bankruptcy Code lists two exceptions to this general rule which are

relevant here. 11 U.S.C. § 523(a)(1)(B) specifies that a tax liability is not dischargeable through bankruptcy if it is either: (1) a tax specified in 11 U.S.C. § 507(a)(8)(C) as “tax required to be collected” from a third party; or (2) a tax for which a return is required but was not given. 11 U.S.C. § 523(a)(1)(B)(i).

Appellant first argues that unemployment insurance tax, like any tax levied upon an employer, is not a tax “required to be collected” under 11 U.S.C. § 507(a)(8)(C). Dkt. No. 5, at 10 (citing *In re Hansen*, 470 B.R. 535 (9th Cir. BAP 2012)). Second, appellant argues that the Stipulation between CDS and the EDD constitutes a return under 11 U.S.C. § 523(a)’s hanging paragraph. For reasons stated below, this court finds that the Stipulation does not constitute a return, and therefore that the unemployment insurance tax and the employment training tax are non-dischargeable for failure to file a required tax return under 11 U.S.C. § 523(a)(1)(B)(i). The court consequently finds it unnecessary to address the applicability of *In re Hansen* to this case.

11 U.S.C. § 523(a)’s hanging paragraph provides the following guidance as to the meaning of the term “return”:

For the purpose of this subsection, the term “return” means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.

In this context, “return” can therefore mean one of three things: (1) a return according to the requirements of applicable nonbankruptcy law; (2) a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986; and (3) a return as a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal. Because the parties neither identify a similar state law nor argue that the Stipulation qualifies as a return similar to a § 6020(a) return, the second definition is not relevant here. Accordingly, the court must determine whether the Stipulation qualifies as a return: (1) under applicable nonbankruptcy law; or (2) as a judgment or a final order entered by a nonbankruptcy tribunal.

Before Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), which amended 11 U.S.C. § 523(a)’s hanging paragraph, the Ninth Circuit adopted a four-factor test to determine whether a document qualifies as a return under 11 U.S.C. § 523(a)’s hanging paragraph. *See In re Hatton*, 220 F.3d 1057, 1060 (9th Cir. 2000) (adopting test first developed in *Beard v. Commissioner*, 82 T.C. 766, 1984 WL 15573 (1984), *aff’d*, 793 F.2d 139 (6th Cir. 1986)). In order to qualify as a return, a document must (1) purport to be a return, (2) be executed under penalty of perjury, (3) contain sufficient data to allow calculation of tax, and (4) represent an honest and reasonable attempt to satisfy the requirements of the tax laws. *Id.* at 767. This court finds that the *Beard* four-factor test is authoritative in the Ninth Circuit and qualifies as applicable nonbankruptcy law under 11 U.S.C. § 523(a)’s hanging paragraph. *See also In re Smith*, No. 13-CV-871-YGR, 2014 WL 17227011 at *23 (N.D. Cal. Apr. 29, 2014) (holding that because the hanging paragraph in § 523(a) does not completely define the term “return,” its amendment does not undermine the four-factor test or years of jurisprudence following *Beard*).

The Stipulation does not qualify as a return because it does not meet the first and second requirements of the *Beard* test. First, the Stipulation does not purport to be a return on its face, and appellant does not argue otherwise. Second, the Stipulation was not signed by appellant, as a responsible person for CDS, under penalty of perjury. The Stipulation therefore fails the *Beard* test and does not constitute a return under 11 U.S.C. § 523(a)’s hanging paragraph.

Appellant argues that pre-BAPCPA courts in *In re Ashe*, 228 B.R. 457 (C.D. Cal. 1998) and *In re Wright*, 244 B.R. 451 (Bankr. N.D. Cal. 2000) held that a document may be considered a return without satisfying the perjury requirement or purporting to be a return on its face if a document: (1) discloses data from which tax liability can be calculated; (2) is executed by the taxpayer; and (3) is lodged with the IRS. However, this line of cases was decided before *Hatton* and the court does not find it persuasive.

Next, the court finds untenable appellant’s argument that the legislative history of Section 523(a)’s hanging paragraph conflicts with and should control over the statute’s plain meaning. Specifically, appellant argues that the legislative history indicates Congress intended that “a

taxpayer who has provided information sufficient to complete a return” to taxing authorities should have his or her tax liability discharged. Dkt. No. 9, at 10 10; *see also* 146 Cong. Rec. S11716, Sec. 714 (daily ed. Dec. 7, 2000). Appellant contends that this intent should control over the plain meaning of “written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal.” This argument fails because the Supreme Court has explained that legislative intent should control only “in the *rare* cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of [the statute’s] drafters.” *United States v. Ron Pair Enterprise, Inc.*, 489 U.S. 235, 242 (1989) (citing *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982) (emphasis added)). This case certainly does not belong to such category because the intent and the plain meaning of the third section are not at odds.

The court agrees with appellee that no judgment or final order was entered in CDS’s administrative petition for reassessment. The Stipulation only resulted in the withdrawal of the petition from the CUIAB. AA 92. Therefore the Stipulation does not qualify as a return under the plain meaning of the third section of Section 523(a)’s hanging paragraph. Consequently, because a tax return is required to be filed under CUIC § 1088(a), but was not filed for the period from the second quarter of 1982 through the second quarter of 1987, the court holds that the unemployment insurance tax and the employment training tax levied in this case are non-dischargeable under 11 U.S.C. § 523(a)(1)(B)(i).

C. State Disability Insurance Withholdings and Personal Income Tax Withholdings are Non-Dischargeable under 11 U.S.C. § 523(a)(1)(A) and 11 U.S.C. § 507(a)(8)(C)

The bankruptcy court found that the state disability insurance withholdings and state personal income tax withholdings to be non-dischargeable under 11 U.S.C. § 523(a)(1)(A) because they are “trust fund” taxes “required to be collected or withheld and for which the debtor is liable in whatever capacity” under 11 U.S.C. § 507(a)(8)(C). AA 689. In his appeal, appellant advances two arguments that these taxes are dischargeable: (1) both Ninth Circuit law and California state statutes indicate that in order to constitute a “trust fund” tax for which an employer is liable, the tax must actually be withheld from employees, and (2) appellant is not personally

liable for the taxes owed by CDS because he did not “willfully fail to pay” them. Dkt. No. 5, at 19–21; 21–24. For reasons stated below, the court finds that both the state disability insurance withholdings and state personal income tax withholdings are non-dischargeable under 11 U.S.C. § 523(a)(1)(A).

Appellant cites several cases and state statutes in support of his first argument. First in *In re Kit Kat Club*, 55 F. Supp. 646, 647 (N.D. Cal. 1944), the court held that “if [an] employer failed to withhold the required amounts from his employee’s wages, there would be no trust fund.” The court also found that an employer is liable only “for contributions on his own behalf,” but is not liable for “payment of the amounts due from his employees.” *Id.* However, *In re Kit Kat Club* is of little relevance to the statute at issue here. *In re Kit Kat Club* was decided in 1944, and interprets Section 44 of the California Unemployment Insurance Act, as amended in 1937, which concerns the priority status, not *dischargeability*, of employment tax claims during bankruptcy. *See id.* at 647. Appellant does not explain why it should control the dischargeability of state disability insurance and state personal income tax withholdings. Moreover, CUIC § 13070(a) plainly imposes liability on the employer for the payment of the state personal income tax withholdings under CUIC § 13020 without regard to whether the withholdings have actually been made.¹ Similarly with respect to the state disability insurance withholdings, CUIC §987 unambiguously holds an employer “liable for any and all contributions” which his employees are required to make regardless of whether actual deductions have been made.² Appellant cites CUIC § 13070(b), which states “whenever any employer or person has withheld any amount pursuant to this division, the amount so withheld shall be held to be a special fund in trust” for the state, the court

¹ CUIC § 13070(a) provides that “[t]he employer shall be liable for the payment of the tax required to be deducted and withheld under Section 13020, and shall not be liable to any person for the amount of such payment.”

² CUIC § 987 provides that “[e]ach employer shall be liable for any and all contributions required to be made by his workers on account of wages which he has paid to them regardless of whether or not he has deducted the contributions from the workers’ wages at the time they were paid, but no employer shall be liable for worker contributions required on behalf of himself or of any of his employees with respect to wages paid while there is in effect at the time the wages were paid a rule or regulation or interpretation of the director or of the department that such wages were not subject to such contributions.”

1 finds this section merely instructive in nature, and that its plain meaning does not indicate an
2 actual-collection requirement.

3 Appellant also cites *In re Shank*, 792 F.3d 829, 831 (9th Cir. 1986), a case in which the
4 Ninth Circuit held that the predecessor of 11 U.S.C. § 507(a)(8)(C), Section 17(a)(1)(e), “excepted
5 from discharge taxes the debtor has collected or withheld from others.” However, the court in *In re*
6 *Shank* simply recited the text of the predecessor statute without analyzing it, before going on to
7 describe the legislative history leading up to the statute’s replacement. The court therefore finds *In*
8 *re Shank* unpersuasive.

9 Cote’s final cited legal authority is the legislative history of 11 U.S.C. § 507(a)(8)(C),
10 which states that “. . . nondischarge [is] recognized for tax claims . . . for withheld income taxes.”
11 S. Rep. 95-989, 95th Cong., 2nd Sess. 1987 at 5800. However, as discussed above, the plain
12 meaning of a statute controls over legislative history in the absence of ambiguity. *Coronado–*
13 *Durazo v. I.N.S.*, 123 F.3d 1322, 1324 (9th Cir. 1997) (citing *Ron Pair*, 489 U.S. at 242). In
14 examining 11 U.S.C. § 507(a)(8)(C)’s text, the court finds no such ambiguity. A tax “required to
15 be collected” is markedly and unambiguously different from a tax an employer “has collected.”
16 The textual basis for an actual-collection requirement simply does not exist in this statute, and
17 therefore the court finds appellant’s first argument untenable.

18 Appellant’s second argument is that he is not personally liable for CDS’s tax liability, as
19 required by 11 U.S.C. § 507(a)(8)(C). The CUIAB found Cote personally liable based on CUIC §
20 1735, which states that any person having charge of a corporation is personally liable for tax
21 liability owed by that corporation if he or she “willfully fails to pay” contributions required of that
22 corporation. Cote argues that he did not “willfully fail to pay” the tax. Dkt. No. 5, at 21–24. In
23 interpreting the phrase “willfully fails to pay,” Cote relies on *Hawkins*, 769 F.3d at 665, which
24 interprets 11 U.S.C. § 523(a)(1)(C). 11 U.S.C. § 523(a)(1)(C) states that a tax which the debtor
25 “willfully attempted in any manner to evade or defeat” will be nondischargeable. The *Hawkins*
26 court holds that “willfully attempted... to evade or defeat [a] tax” requires “[a] specific intent to
27 evade the tax,” not merely “spending in excess of income” or “living beyond one’s means.” Cote

1 argues that this court should follow *Hawkins*' holding in interpreting the willfulness element in
2 CUIC § 1735. Since the administrative law judge at the CUIAB found only that Cote had a
3 preference for paying certain creditors over others, but not a specific intent to evade (AA 144),
4 Cote argues that he did not "willfully" fail to pay and should not be personally liable for CDS's
5 tax liability under CUIC § 1735.

6 However, the court finds the willfulness element in CUIC § 1735 and that in 11 U.S.C. §
7 523(a)(1)(C) distinguishable. Appellant neglects to cite the preceding section of *Hawkins*, in
8 which the court discussed the difference between "willfully fail to pay" and "willfully attempt to
9 evade or defeat a tax." *Hawkins*, 769 F.3d at 668. The *Hawkins* court found that the Supreme
10 Court in *Spies v. United States*, 317 U.S. 492, 498 (1943) rejected the argument that a willful
11 failure to pay tax, coupled with a willful failure to file a return, constitutes a willful attempt to
12 evade or defeat a tax. *Id.* It is clear from this holding that both the Supreme Court in *Spies* and the
13 Ninth Circuit Court of Appeals in *Hawkins* recognize a distinct difference between the two
14 phrases, with "willfully attempt to evade or defeat a tax" being the more serious violation. In the
15 former case, the adverb "willful" modifies the verb "to pay," whereas in the latter case "willful"
16 modifies the verb phrase "attempt to evade or defeat." Accordingly, a taxpayer can willfully fail to
17 pay without attempting to evade or defeat the tax.

18 The court finds *In re Jercich*, 238 F.3d 1202, 1208 (9th Cir.2001) instructive in defining
19 willfulness in the context of 11 U.S.C. § 523(a). In *Jercich*, the Ninth Circuit Court of Appeals
20 defines willfulness, as required for nondischargeability under 11 U.S.C. § 523(a)(6), as a
21 "deliberate act with knowledge that the act is substantially certain to cause injury." According to
22 the record, Cote was aware of outstanding tax liability resulted from the Stipulation, yet he
23 continued to operate CDS as the president without directing payments for the tax liability owed to
24 the EDD for almost two years before dissolving the company, thus injuring the state by making it
25 an unwilling creditor. AA 144. This act clearly constitutes a willful failure to pay contributions
26 under CUIC § 1735. The court therefore finds that Cote is personally liable for the contributions
27 and withholdings owed to the EDD by CDS. Because the state disability insurance withholdings

1 and state personal income tax withholdings are taxes required to be collected under CUIC § 13020
2 and for which appellant is liable under CUIC § 13070(a) and § 987, the court finds them non-
3 dischargeable under 11 U.S.C. § 523(a)(1)(A) and 11 U.S.C. § 507(a)(8)(C).

4 **III. ORDER**

5 For the reasons set forth above, the judgment of the bankruptcy court is AFFIRMED.

6 **IT IS SO ORDERED.**

7 Dated: September 29, 2015



Ronald M. Whyte
United States District Judge

United States District Court
Northern District of California